

Central Intelligence Agency



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DIRECTORATE OF INTELLIGENCE

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MEMORANDUM FOR: William Martin
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for National Security Affairs
National Security Council

FROM: [redacted] 25X1
Chief, Strategic Resources Division
Office of Global Issues

SUBJECT: Western Europe: Moving Toward Gas Security? [redacted]

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Attached is our assessment of the impact of the outcome of the Sleipner gas negotiations on West European gas security. If you have any questions, please call me [redacted]

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Attachment:
Western Europe: Moving Toward Gas Security?
GI M 84-10105, June 1984 [redacted]

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SUBJECT: Western Europe: Moving Toward Gas Security?

OGI/SRD/EMB [REDACTED] (14 June 1984)

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Western Europe: Moving Toward Gas Security?Summary

The United Kingdom is engulfed in a political debate over the necessity of importing large, new quantities of natural gas from Norway's Sleipner field. Some British officials oppose these imports because of balance of payments implications and favor a smaller volume of Dutch gas imports. In addition, several oil companies believe domestic production can be stepped up to meet demand. The outcome of London's gas negotiations with Norway and the Netherlands could have major implications for the security of gas supplies in Western Europe during the next decade. Failure to proceed quickly with the development of the Sleipner field could delay or postpone development of Norway's Troll field--a future source of gas needed to prevent further inroads by the Soviet Union into the West European gas market in the 1990s. In our judgment, going ahead with the Dutch option would enhance West European security by integrating the pipeline network between the continent and the United Kingdom. Over the longer term, however, such a link could provide Moscow with an opportunity to penetrate the UK market.

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This memorandum was prepared by [redacted] Energy Markets Branch, Office of Global Issues. The information contained herein is updated to 7 June 1984. Comments may be directed to [redacted] Chief, Strategic Resources Division [redacted]

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Western Europe: Moving Toward Gas Security?Market Setting

The prospects of increasing gas demand and declining indigenous production in Western Europe indicate that both continental Europe and the United Kingdom--currently two distinct markets due to the absence of any interconnecting pipeline--will become increasingly reliant on natural gas imports over the balance of the century. Current forecasts project that natural gas demand on the Continent will increase from 167 bcm in 1983 to approximately 200 bcm in the mid 1990s, with only about 85 percent of projected requirements covered by indigenous production and existing supply contracts. Prospective suppliers now include the Netherlands, Norway, the USSR, and Algeria and competition for incremental market share likely will be stiff.

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Marketing efforts by Norway and the Netherlands--secure OECD suppliers--are under way both on the Continent and in the United Kingdom. Although the United Kingdom is a major European gas producer and now meets about three-fourths of its requirements from indigenous production, the British Gas Corporation (BGC) also imports about one-fourth of its gas from Norway. Declining production from Britain's southern basin gasfields and termination of Norwegian deliveries from the Frigg field in the early 1990s point to a potential gas supply gap in the United Kingdom of around 31 bcm in 1995, according to the BGC. Unlike most other European buyers, BGC is moving now to fill these projected needs.

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Meeting British Needs

After 18 months of negotiations, the Norwegian state oil company (Statoil) and the BGC reached an understanding in February for the purchase of about 12-14 bcm of natural gas from Norway's Sleipner field. Sleipner gas supplies are expected to be developed by the early 1990s and would roughly offset the loss in supplies from the Norwegian Frigg gasfield. The gas deal is subject to both British and Norwegian parliamentary approval.

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Some British officials, however, have voiced reservations about the agreement. In particular, Nigel Lawson, Chancellor of the British Exchequer and former Energy Secretary, has played a key role in opposing the deal because of the potential financial implications. According to some British economists, the \$28 billion gas deal would cause a net outflow of payments of around \$2.1 billion a year. In addition, the cost to the Treasury from lost tax revenues could amount to more than \$4.2 billion over the lifetime of the field if these volumes were produced domestically. For these reasons, Chancellor Lawson has advocated increased reliance on domestic gas production and imports from

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the Netherlands as an alternative to the purchase of Sleipner gas. In February, the UK Department of Energy instructed the BGC to explore the possibility of purchasing natural gas from Gasunie, the Dutch state gas utility. [redacted]

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Although the Dutch have not previously sold gas to the United Kingdom, the Netherlands now has additional gas available for export and Gasunie has offered to supply the British with about 5 bcm per year possibly beginning as early as 1990--less than half the volume that would be available from Sleipner. Although the initial offer was at a price about 20 percent higher than the Sleipner price, Gasunie recently made a more competitive offer and indicated its willingness to negotiate. With only lukewarm interest expressed recently by Continental buyers in additional Dutch gas volumes, the Hague would like to penetrate a new gas market in the United Kingdom. We believe any Dutch sales to London would reduce future availability of Dutch gas to Continental buyers. At the same time, the outcome of London's gas negotiations with Norway and the Netherlands could have major implications for the security of gas supplies in Western Europe during the next decade. [redacted]

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The Politics of Negotiation

The Sleipner gas deal is a major and complex political issue in the United Kingdom, and its outcome is far from certain. Nigel Lawson, who has close connections with Prime Minister Thatcher, opposes the deal [redacted]

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On the other hand, Sir Dennis Rooke, chairman of the BGC, strongly supports the deal. Although Rooke has a good reputation in the gas industry, his relations with the current Government are poor, according to Embassy sources.

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The Sleipner Option

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A British decision to proceed with the Sleipner agreement would provide a secure and certain source for meeting around one-fourth of British gas demand in the 1990s. Even with Sleipner gas imports of 12-14 bcm annually, however, the UK would still require increased domestic production, according to the BGC.

Indeed, BGC is currently engaged in its largest ever exploration program--spending \$140 million annually on domestic gas exploration--and plans to negotiate for 25 new British gas fields by 1995. With a statutory requirement to ensure supplies for 16 million customers, the BGC views the Sleipner deal as a prudent course. Moreover, the agreed upon price is favorable to BGC and the corporation probably wants to finalize the agreement soon given the current buyers' market for natural gas in Western Europe. [redacted]

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Viewing the Dutch Option

Some UK officials [redacted] have proposed increasing domestic production and importing Dutch gas to meet future demand needs. [redacted] the lower volume of Dutch gas imports would have a less adverse effect on the balance of payments, and increased domestic production could benefit the British offshore industry. Some companies have recently unveiled significant new gas development plans in the British sector and have stated that there is no need for Norwegian imports:

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- o Conoco intends to develop four new North Sea gasfields with recoverable reserves of 70 bcm at a cost of over \$1 billion and claims that southern basin gas reserves are sufficient to meet British requirements to the year 2000.
- o British Petroleum (BP) recently stated that enough British gas reserves are recoverable at a price comparable to the Sleipner price to meet domestic needs until after the year 2000 and has announced it will develop four gasfields in the southern sector of the North Sea capable of producing about 4 bcm annually.



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Without Sleipner, however, the British gas industry will have to find and develop more than the equivalent of about three-quarters of its current output to satisfy demand requirements when Frigg gas supplies terminate. To meet such an ambitious target, British offshore gas would have to be developed much faster over the next 10 years than it was during the boom years of the 1970s. Given the uncertainties surrounding demand, indigenous supply, and balance of payments implications, [redacted]

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[redacted] London may eventually approve the Sleipner contract with lower volumes and possibly take some Dutch gas as well. Under this scenario, London may also change its current policy of forbidding export of UK North Sea gas, according to embassy reporting. Dutch supplies could be used to meet British needs in the 1980s, while Norwegian supplies would

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come on line in the 1990s in combination with maximum domestic production. [redacted]

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Outlook and Implications

In our judgment, the security of gas supplies in Western Europe over the next decade will be influenced by the outcome of the Sleipner contract. A decision by London to approve the Sleipner purchase would improve prospects for marketing the Norwegian Troll field. Oslo has stated that progress on Troll would be delayed pending resolution of Sleipner sales. Troll is the only large, secure OECD gas supply available and capable of meeting Continental requirements in the 1990s. Because of the 10-year leadtime for Troll development, we believe a decision to proceed with the project in the next year or so is essential to prevent significant additional Soviet gas sales to the West Europeans in the 1990s. [redacted]

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Alternatively, a decision by London to rely on increased indigenous production and some smaller volume of Dutch gas imports could be more problematic, if--as we believe--domestic output falls short of expectations. The United Kingdom would then be forced to seek additional imports, either from Norway, or potentially the Soviet Union. The Soviet option would become available to London if Dutch gas were imported, creating the necessary conduit to bring in Soviet gas in the future. A pipeline link to the Continent from the UK to import Dutch gas, however, could enhance European gas security through integrating the distribution network. [redacted]

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We believe London will eventually approve the purchase of Sleipner gas. British Department of Energy officials, however, may instruct BGC to reduce the volumes agreed to in the original deal because they believe domestic production can be increased significantly.

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Beyond Sleipner

The willingness of West European gas suppliers to adjust to the realities of a weak energy market could have a positive impact on West European gas security. Norway and the Netherlands--which account for 70 percent of proved European gas

reserves--have shown considerable price flexibility recently in making available additional gas supplies. The Norwegian price offer to the United Kingdom on Sleipner gas was well below its 1980 deal to sell Statfjord gas to the continent, and lower than the Norwegians seemed determined to get six months ago. Such price flexibility is probably a prerequisite to the development of Troll's huge reserves. Although the Dutch initially misread the market, the Hague showed a pragmatic stance by submitting a more competitive offer to the United Kingdom and indicating a willingness to negotiate further. On the Continent, the Dutch have offered to provide additional gas supplies to Italy at the present price. Two months ago, the Dutch were demanding a higher price as a premium for being a secure gas supplier

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Given the price flexibility of suppliers, the prospect of enhancing gas security now rests primarily with consumers. In gas contract renegotiations scheduled to occur this year with the Dutch, consumers probably will have the opportunity to take additional volumes of Dutch gas beyond contract expiration dates. Indeed, the Hague has indicated a willingness to offer buyers a 10-year extension of current contracts, which run into the 1990s. Additional Dutch gas supplies have the potential to partially meet future demand growth and minimize Soviet sales until Troll can be developed in the mid-to late 1990s.

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Price flexibility on the part of Norway and the Netherlands, however, may not be enough to attract consumers. Although the Dutch offered additional gas supplies at competitive prices, Rome recently opted for Soviet gas and lucrative counter-trade agreements. As a result of signing for Siberian gas, Rome hopes to make sales of \$600-800 million to Moscow by 1990, beginning with the signing of a \$150 million contract for the construction of an experimental coal slurry pipeline in the Soviet Union, according to embassy reporting. Thus even if the Sleipner agreement is approved and the outlook for Troll development brightens, the prospect of receiving lucrative Soviet contracts in return for gas purchases could lure some West European consumers to purchase additional Siberian gas in the 1990s.

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